TWIA Reform and Summary of APCIA Proposal

The Texas Sunset Commission issued a report on TWIA in 2018 stating that the program's current funding cannot be sustained if there are further catastrophic events, and that TWIA is broke, in debt, and facing a shrinking revenue pool. In 2019 the Texas legislature created a special legislative task force to make recommendations for reform of TWIA's funding structure. APCIA hopes to proactively support responsible and effective reforms that provide a funding structure that is transparent, fair and sustainable.

TWIA was established in 1971 to serve as an "insurer of last resort" to provide windstorm insurance along the Texas seacoast, currently providing roughly 41 percent of the wind and hail coverage (by policy count) in the 14 eligible coastal counties at significantly below-market rates. TWIA has been the subject of constant political debate since its formation. It became financially jeopardized in 2008 by Hurricane Ike, receiving more than 90,000 claims, which took more than 250 days on average to pay, with over 11% of the claims disputed. The claims settlement process did improve following Hurricane Harvey, with over 76,000 claims, which took on average 35 days to pay, and just under 2% were disputed.

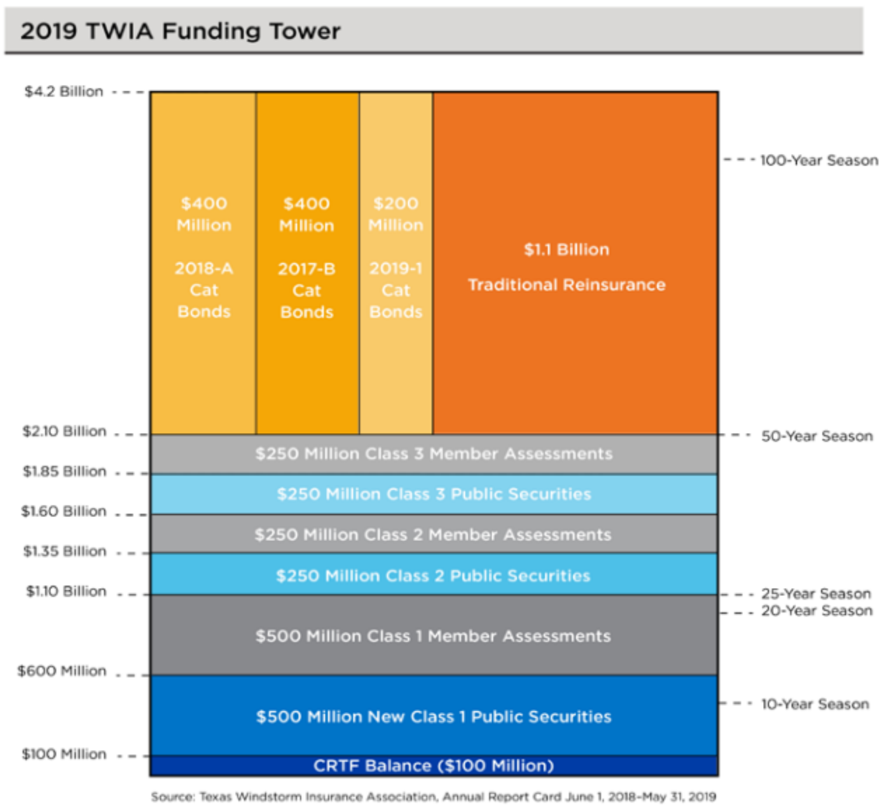
TWIA's actuaries have indicated that its residential and commercial rates need to increase 42 for personal property and 50 percent for commercial property. The current dependence on bonds for payment of catastrophe losses is a major factor in this rate deficiency with 27 percent of 2020 TWIA premium going to bond/debt repayment. This is not a sustainable model.

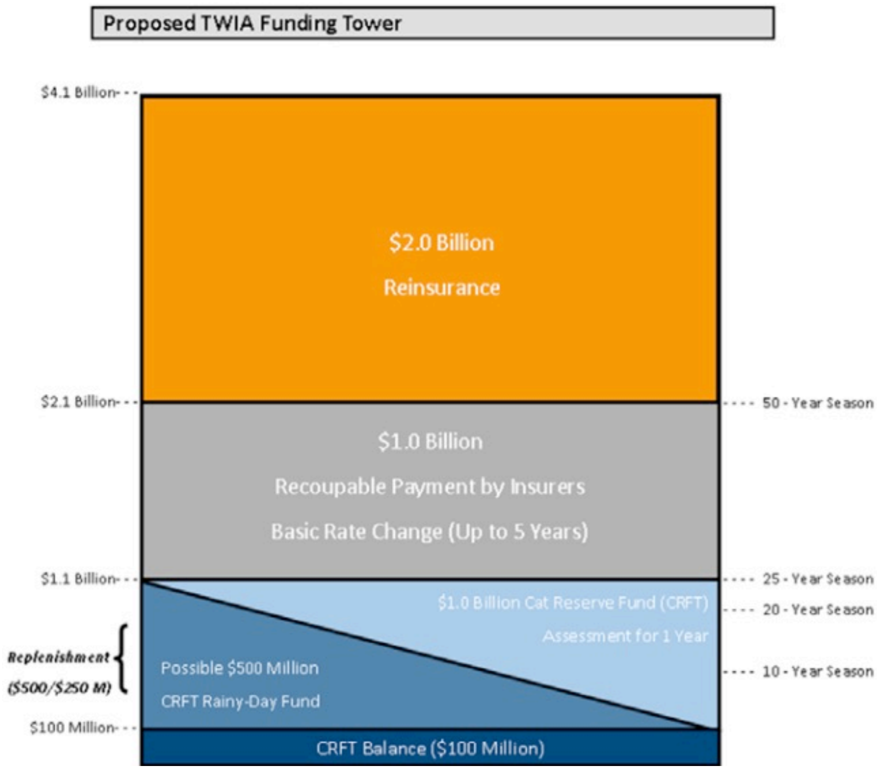
APCIA has spent significant time and resources examining all of the different state coastal programs (from Texas through North Carolina) to compare their board makeups, coverage limits, types of policies written, size, exposure, premiums, funding layers (including reinsurance programs), post-event funding and assessments, and plans of operation. After numerous conversations with market participants, a consensus emerged to proactively propose revamping the TWIA funding tower to remove the $1 billion possible bond load and shift the private sector insurance exposure in Texas to a higher working level than the current insurance tower.

Specifically, the policy proposal would replace TWIA's current 8 layers that include policyholder assessments, industry payments, post-event bonds and reinsurance with a simpler 5-layer plan. The industry skin in the game would be similar, but at a higher working level. The re-layering of the towers would also be more transparent and put TWIA on sounder financial footing. Instead of hiding subsidies through assessments of insurers that are passed on to all Texas property insurance policyholders, there would be broader and transparent participation by all Texas property policyholders.

The plan should also require and enforce stronger building codes, ideally resulting from a partnership with the Insurance Institute for Business & Home Safety (IBHS). The graphs on the next page compare the current and proposed tower.

APCIA believes this proposed alternative program structure offers the advantages of a stable funding regime for TWIA going forward that distributes the risk burden of damaging wind events while providing the flexibility of industry involvement and the potential to leverage the advantages of the reinsurance marketplace when needed.





SUGGESTED TWIA FUNDING REFORM

As we look toward the 2021 Texas legislative session, APCIA and other interested stakeholders have proposed changes to TWIA to make it among the most effective beach plans in the United States. The following outline includes steps for success in this endeavor.

Proposed Structure

Restructure the first several layers of TWIA with a more stable allocation. TWIA would be funded (beyond premiums) through two main layers before relying upon other financing mechanisms, such as reinsurance or cat bonds.

- Establish and sustain a $1 billion minimum first layer composed of current available premium plus the catastrophe reserve fund trust (CRTF). There would be a statewide surcharge on all Texas property insurance policyholders (personal and commercial) collected by insurers to fund this.
- The $1 billion would be collected by insurers and transparently shown on the Declarations page of each policy.
- The CRTF would be accessed once TWIA premiums are exhausted.
- The CRTF would be used to pay for catastrophic event claims made by TWIA policyholders.
- Once available premium plus the CRTF falls below a "to be determined" threshold (e.g., $250-$500 million), another assessment on all Texas property insurance policyholders would be levied to "make it whole" and prepare for the next such event.
- **The second/next $1 billion (in excess of the CRTF) would be paid by the p/c insurance industry providing property insurance coverage in Texas** and be recoupable through reinsurance and/or including it in rates charged to property insurance policyholders owners throughout the state.

- The first layer would be "funded" and not established through pre-event or post-event bonds and the industry would be responsible for the second billion when needed.
- Amounts in excess of $2 billion would be covered (up to at a minimum the 100-year PML – currently) by reinsurance products purchased by TWIA.
- There would be a **statutory MINIMUM 5 percent premium increase in TWIA rate**s until such time as the rates are adequate, within 20 percent of the indicated rate established by an outside actuarial firm, or five years.
- There would be a strengthening of the TWIA building codes through rulemaking adoption of the strongest codes as recommended by the Insurance Institute for Business and Home Safety (IBHS).
- Consideration should be given for a plan to fund $500 million of the CRTF from Texas' rainy-day fund to reduce the subsidy amount and make it more politically affordable/acceptable initially. It would also allow this fund to be set up and fully funded more quickly and mean a lower assessment for property policyholders.

Advantages to this proposal:

- $1 billion from property policyholders across the state would include a one-year initial surcharge of approximately 7% per policy.
- $1 billion (from industry) would be stable
- $2 billion (or more) from reinsurance marketplace (perhaps at a lower cost due to the stability of the underlying funds and other TWIA changes (premium increases, mitigation, building codes, etc.).
- Removes the "stigma" associated with bonding, having to pay the bonds back, etc.
- It is temporary, unless there's a significant drain on the CRTF and then it could be replenished quickly through another property policyholder assessment
- It would be based on a percentage of the premiums paid – not a flat amount
- Everyone has a "stake in the game" and it would be transparent to all involved: coastal property owners, inland property owners, the state, insurers, reinsurers, etc.
- There's an opportunity (no events for a year or more) to grow the fund – i.e., investment income.
- Language would be included in the legislation that would prevent the state from accessing the funds for any other purpose. This would allow for market (property growth) and further, at least in theory, stabilize the marketplace
- The gradual, but mandatory rate increase means that the private market may be more willing to compete, so the TWIA would get smaller.
- Since assessments would be on all properties in the state, if TWIA shrinks, the potential losses (and proportionate surcharges) will as well.

Separately, consider a plan to fund $500 million of the CRTF from Texas' rainy-day fund to reduce the subsidy amount and make it more politically affordable/acceptable initially. It would also allow this fund to be set up and fully funded more quickly and mean a lower assessment for property policyholders.

Sincerely,

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